

Our Ref: AJ
Your Ref:



19 November 2008

Huntley Management Limited
Suite 301, 3rd Floor
37 Bligh Street
SYDNEY NSW 2000

Attention: John Knox

Dear John

Consolidated Water Supply Agreement (CWSA)

We refer to our discussions of 18 November, 2008.

In relation to the above agreement, we note as follows:

1. The CWSA is an agreement between Australian Olives Limited (**AOL**) as the Manager, Australian Olives Holdings Limited (**AOHL**) as the Water Owner and Collective Olive Groves Limited (**COGL**) as the Land Owner.
2. Clause 7.1(a) of the CWSA provides that the whole of clause 7.1 applies if, amongst other things, "for any reason there is a removal of retirement of the Manager under the (Corporations) Act."
3. The Manager is AOL. It has been removed under the Corporations Act and therefore clause 7.1 applies.
4. Clause 7.1(b) provides that if the Manager i.e. AOL is not the manager of the olive groves on the land then from the time that it ceases to be the manager of the Olive Groves:
 - 4.1 the Manager is released from any further obligation to pay the annual base fee under the agreement;
 - 4.2 AOHL and COGL must **immediately** enter arrangements with each other on substantially the same terms as the CWSA in order to maintain a water supply to the Groves or (assume typo and should be "on") that part of the land planted to olive trees, as the case may be, which includes:
 - (a) AOHL and COGL entering into a lease substantially on the same terms as the Water Land Lease; and,
 - (b) payment of the annual base fee by COGL to AOHL which will be payable from the date that AOL has been

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removed as the manager;

- 4.3 AOL must transfer ownership of the Pumping Equipment and Reticulation Equipment to COGL at a price to be agreed between AOHL and COGL which they have agreed will be no less than the replacement cost of the Pumping Equipment and Reticulation Equipment at the time of the removal of AOL as the manager together with the cost of associated civil works that would be required to install such equipment. If there is a dispute between AOL and COGL about the replacement cost then there is a dispute resolution procedure which involves appointment of an expert nominated by the president for the time being of the Australian Institute of Chartered Accountants to determine the replacement cost.
5. It should be noted that there is no provision for the CWSA to continue in the event that AOL is removed as the manager of the Projects but to the contrary it is clear that it came to an end.
6. Further we note that payments under the CWSA are not payments for which AOL was entitled to be indemnified out of the scheme property of the Projects and therefore is a liability that remains with AOL pursuant to section 601FS(2)(d) of the Corporations Act, 2001. This means that section 601FT(2) applies and therefore your company has not become a party to the CWSA on its appointment as responsible entity.
7. We have concerns about the above provisions from the Growers' perspective because each of AOL and AOHL appear to us to be related parties of COGL with common directorships. There is a clear conflict of interest in relation to matters which affect each of those companies. AOHL and COGL can at present simply agree on the replacement cost. Shareholders of COGL would then have to take action against the directors for breach of their director duties which would be difficult because the directors may seek to rely on the business judgment rule. If shareholders wish to challenge the replacement value it is recommended they obtain their own independent valuation before taking action against the directors. In the meantime representatives of the shareholders of COGL should put the directors on notice of their duties as directors and not to transfer the equipment at some arbitrary price agreed by themselves.
8. We also have concerns that the water supply has been cut off to the Groves whereas such water is supposed to be supplied to the Groves under the above arrangements. We note that there are representations in the PDS for Project 6 to this effect. We recommend we write to COGL and ask what they are doing to ensure supply of the water to the Groves in accordance with the above arrangements.
9. We have correspondence from Harris and Harris which states:
- "We are instructed that COGL does not have sufficient funds either to pay for the pumping and reticulation equipment or to pay for water pursuant to a water supply agreement on substantially the same terms as the CWSA. In those circumstances, we are instructed that the directors of COGL have taken the view that compliance with clauses 7.1(b) and/or 7.1(c) would render the company insolvent. Our client has at present not enforced compliance with clause 7.1(b) as it does not consider it to be in its interests to enter into

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agreements with a company which it reasonably believes will be unable to comply with those agreements."

and,

"..on our instructions, should COGL enter into a long term agreement to purchase water, with no right to any additional fees or harvest distributions, that transaction could, on our instructions, render COGL insolvent."

This suggests that there may be solvency issues with COGL. However this would appear to only be as a result of decisions made by the common directors of each of the companies. There must be a query on whether the directors may have breached their statutory and fiduciary duties.

10. We note that in the following product rulings, it is stated that the Growers are entitled to a deduction relating to water facilities (e.g. irrigation):

- PR 2004/7 – Project 6 - paragraphs 55 and 56
- PR 2003/26 – Project 5 – paragraphs 57, 57, 64-66
- PR 2001/66 – Project 4 – paragraph 68
- PR 2000/36 – Project 3 – paragraph 55

In order for the Growers have been entitled to the deductions for the stated expenditure in the Product Rulings on the water facilities, the Growers must have been the entity which incurred the expenditure ⁽¹⁾. Unfortunately we do not have any details as to what water facilities this expenditure relates. There is no indication in the Grove Agreements. However looking at the product rulings, the expenditure by the Growers for the total remuneration payable to the responsible entity under the relevant agreements has been split for the purposes of the product ruling into components of which the expenditure on the water facilities forms a part notwithstanding the remuneration is said to be in consideration of the responsible entity carrying out its duties.

"Water facility" is currently defined in the ITAA 97 as:

- "(a) plant or a structural improvement, or a repair of a capital nature, or an alteration, addition or extension, to plant or a structural improvement, that is primarily and principally for the purpose of conserving or conveying water; or
- (b) a structural improvement, or a repair of a capital nature, or an alteration, addition or extension, to a structural improvement, that is reasonably incidental to conserving or conveying water."

The ITAA 97 gives examples of a water facility as including a dam, tank, tank stand, bore, well, irrigation channel, pipe, pump, water tower and windmill and examples of

¹ former section 387-125 and section 40-525 of the *Income Tax Assessment Act, 1997 (ITAA 97)*

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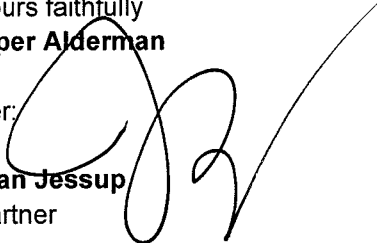
things reasonably incidental to conserving or conveying water as including a culvert, a fence to prevent livestock entering an irrigation channel and a bridge over an irrigation channel (²).

Therefore the expenditure which has been incurred by the Growers has been on something within this definition. Nevertheless without further information it is not clear to what the water facilities this expenditure relates other than it must be something within this definition. There is nothing apparent in the disclosure documents we have for Projects 5 or 6 that is of any assistance.

Nevertheless it would appear to us to be arguable that because it is the Growers who have incurred the expenditure on the water facilities then the ownership in those water facilities must vest in the Growers upon the incurring of that expenditure to acquire the same unless there is some condition to the contrary in the agreements which we cannot find. It is merely a question of determining what are the relevant water facilities and whether these are the equipment referred to in the CWSA.

If you have any queries please do not hesitate to contact us.

Yours faithfully
Piper Alderman

Per: 
Alan Jessup
Partner

² section 50-520 of the ITAA 97